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SERVICE DATE - NOVEMBER 7, 2003

SURFACE TRANSPORTATION BOARD

STB Finance Docket No. 33388 (Sub-No. 94)

CSX CORPORATION AND CSX TRANSPORTATION, INC.,
NORFOLK SOUTHERN CORPORATION AND
NORFOLK SOUTHERN RAILWAY COMPANY
— CONTROL AND OPERATING LEASES/AGREEMENTS —
CONRAIL INC. AND CONSOLIDATED RAIL CORPORATION

[PETITION FOR SUPPLEMENTAL ORDER]

Decision No. 2

Decided: November 5, 2003

In this decision, the Board authorizes petitioners¹ to carry out a “Supplemental Transaction” that involves (i) the consolidation of the business, assets, and operations of New York Central Lines LLC (NYC) within CSXT, and (ii) the consolidation of the business, assets, and operations of Pennsylvania Lines LLC (PRR) within NSR, including (with respect to each such consolidation) the intermediate and related transactions described in great detail in Decision No. 1 (served July 9, 2003, and published at 68 FR 42159 on July 16, 2003), slip op. at 5-6.

BACKGROUND

In a decision served July 23, 1998,² the Board approved, subject to various conditions, a CSX/NS/Conrail “control” application (the Conrail Application) that had been filed on June 23, 1997, by CSX, NS, and Conrail. The application that CSX, NS, and Conrail filed, and that the Board (with certain exceptions) approved, contemplated the acquisition by CSX and NS of control of Conrail, and the division of the assets of Conrail by and between CSX and NS, to the extent and in

¹ CSX Corporation (CSXC) and CSX Transportation, Inc. (CSXT), and all other entities wholly owned (directly or indirectly) by CSXC, are referred to collectively as CSX. Norfolk Southern Corporation (NSC) and Norfolk Southern Railway Company (NSR), and all other entities wholly owned (directly or indirectly) by NSC, are referred to collectively as NS. Conrail Inc. (CRR) and Consolidated Rail Corporation (CRC), and all other entities wholly owned (directly or indirectly) by CRR, are referred to collectively as Conrail. CSX, NS, and Conrail are referred to collectively as petitioners.

² CSX Corp. et al. — Control — Conrail Inc. et al., 3 S.T.B. 196 (1998) (Decision No. 89).

the manner provided for in a “Transaction Agreement” that had been entered into by CSX, NS, and Conrail on June 10, 1997. Pursuant to Decision No. 89, acquisition of control of Conrail was effected by CSX and NS on August 22, 1998 (the Control Date), and the division of the assets of Conrail by and between CSX and NS was effected on June 1, 1999 (the Split Date). The transaction that the Board approved in Decision No. 89 is referred to as the Conrail Transaction.

Since the Control Date, CRC has been controlled by CSX and NS through a chain of holding companies. CRC is a direct wholly owned subsidiary of CRR; CRR is a direct wholly owned subsidiary of Green Acquisition Corp. (Green Acquisition); Green Acquisition is a direct wholly owned subsidiary of CRR Holdings LLC (CRR Holdings); and CRR Holdings is jointly owned by CSXC and NSC (CSXC holds a 50% voting interest and a 42% equity interest in CRR Holdings; NSC holds a 50% voting interest and a 58% equity interest in CRR Holdings). In accordance with the Transaction Agreement, each of CRR and CRC has been managed (since the Control Date) by a board of directors consisting of six directors divided into two classes, each class having three directors. On each board, CSXC has had the right to designate three directors and NSC has likewise had the right to designate three directors; and actions that require the approval of either board have required approval both by a majority of the directors on that board designated by CSX and by a majority of the directors on that board designated by NS.

On the Split Date, CRC’s rail operating properties were divided into two categories: Allocated Assets (which were allocated either to NYC for operation by CSX or to PRR for operation by NS) and Retained Assets (which were retained by CRC for operation for the benefit of both CSX and NS). The “NYC Allocated Assets” consist principally of former New York Central rail lines, including lines running from New York/New Jersey through Albany and Buffalo to St. Louis, and from Albany to Boston, and certain owned and unencumbered rolling stock of Conrail. The “PRR Allocated Assets” consist principally of former Pennsylvania Railroad lines, including lines running from New York/New Jersey and Philadelphia through Pittsburgh and Cleveland to Chicago, and certain owned and unencumbered rolling stock of Conrail. The Retained Assets consist primarily of the three Shared Assets Areas (SAAs): the North Jersey SAA (NJSAA); the South Jersey/Philadelphia SAA (SJ/PSAA); and the Detroit SAA (DSAA).³

Although the Conrail Transaction contemplated that the vast majority of Conrail’s assets (i.e., all assets included in the Allocated Assets category) would become part of either the CSX rail system or the NS rail system, these assets were not transferred outright to CSX and NS. Rather, these assets were transferred to NYC and PRR for operation by CSX and NS, respectively; and NYC and PRR are both wholly owned subsidiaries of CRC. On the Split Date: (1) CRC transferred to NYC

³ CRC also retained certain equipment encumbered by financing arrangements. The operation and control of this equipment were allocated to CSXT or NSR pursuant to equipment subleases and other operating agreements.

ownership of the CRC railroad assets designated for CSX's exclusive use and operation (i.e., the NYC Allocated Assets), and CRC transferred to PRR ownership of the CRC railroad assets designated for NS's exclusive use and operation (i.e., the PRR Allocated Assets); and (2) NYC entered into an Allocated Assets Operating Agreement with CSXT, granting CSXT the exclusive right to operate and use the assets of NYC, and PRR entered into an Allocated Assets Operating Agreement with NSR, granting NSR the exclusive right to operate and use the assets of PRR. On and after the Split Date, the ownership of the NYC and PRR Allocated Assets remained within the corporate structure of Conrail, but the operation and general day-to-day management of these assets has been (and is now) conducted separately by CSXT and NSR, respectively.

Under the terms of the Transaction Agreement and the LLC agreements establishing NYC and PRR, CSX has the right to manage NYC and to designate its officers and directors, and NS has the right to manage PRR and to designate its officers and directors. Certain major decisions of NYC and PRR, however, have been reserved to CRC, which can act in that respect only with the indirect approval of both CSXC and NSC pursuant to their respective 50% voting interests in CRC's ultimate parent (CRR Holdings).

The NYC and PRR Allocated Assets Operating Agreements have fixed terms of 25 years (with options for two subsequent renewal periods), and require return of the subject rail assets by CSXT to NYC and by NSR to PRR upon termination or expiration of the agreements. The agreements also provide that an Operating Fee (analogous to rent) is to be paid by each operating railroad (CSXT and NSR) to its respective counterparty (NYC and PRR) quarterly. The agreements further provide that, every 6 years after the Split Date, the Operating Fee is to be revalued and reset to the then-current "Fair Market Rental Value," defined as the rent that would be negotiated at arm's length between parties under no compulsion to lease.

THE CSX/NS-1 SUPPLEMENTAL ORDER PETITION

On June 4, 2003, petitioners (CSX, NS, and Conrail) filed a petition (designated CSX/NS-1) for a supplemental order⁴ authorizing the Supplemental Transaction, which proposes to consolidate NYC with CSX and consolidate PRR with NS). The Supplemental Transaction includes, with respect to each of the two consolidations, a number of intermediate and related transactions that were described in great detail in Decision No. 1. See Decision No. 1, slip op. at 5-6. The Supplemental Transaction will also require a restructuring of certain Conrail debt obligations (the Proposed Debt Restructuring). The Proposed Debt Restructuring was also described in great detail in Decision No. 1. See Decision No. 1, slip op. at 9-13.

⁴ 49 U.S.C. 11327 provides: "When cause exists, the Board may make appropriate orders supplemental to an order made in a proceeding under sections 11322 through 11326 of this title."

In Decision No. 1 (served July 9, 2003), the Board established a procedural schedule for the processing of the CSX/NS-1 petition. That procedural schedule provided that petitioners would have until July 17, 2003, to clarify whether the Proposed Debt Restructuring applies to Conrail's preexisting debt obligations (i.e., the obligations that existed on the Split Date and that continue to exist today) or to Conrail's current debt obligations (i.e., the obligations that existed on the Split Date and that continue to exist today, and, in addition, any post-Split Date obligations incurred by Conrail). The procedural schedule established in Decision No. 1 further provided: that petitioners would have until July 29, 2003, to serve copies of Decision No. 1 on all parties of record in STB Finance Docket No. 33388 and on all known holders of Conrail's relevant debt and equipment lease obligations, and to certify in writing that such service had been accomplished; that any person who wished to file comments respecting the petition would have until August 28, 2003, to file such comments; and that petitioners would have until September 25, 2003, to reply to any such comments.

By letter dated July 17, 2003, petitioners advised that, with one exception, the Proposed Debt Restructuring involves only preexisting debt obligations. The one exception cited by petitioners involves a \$6.774 million principal amount of debt that originally represented preexisting debt (lease) obligations with a termination date of February 2000. Petitioners advise that, prior to the end of that particular lease (which contained a mandatory purchase obligation), the lessors offered Conrail the option of exercising its purchase obligation for the underlying equipment using a conditional sales agreement. Petitioners further advise that Conrail undertook the offered transaction, and, accordingly, incurred a single "post-Split Date" debt obligation that has a remaining principal balance of \$2.6 million and that is now set to mature in February 2005.

By letter dated July 29, 2003, petitioners certified that copies of Decision No. 1 were served on all parties of record in STB Finance Docket No. 33388 and on all known holders of Conrail's relevant debt and equipment lease obligations, including the holders of the "post-Split Date" lease obligation described in the letter dated July 17, 2003.

On or about August 28, 2003, comments respecting the Supplemental Transaction and/or the Proposed Debt Restructuring were submitted by the New York City Economic Development Corporation (NYCEDC), the Commonwealth of Massachusetts (the Commonwealth), the Ad-Hoc Conrail Bondholders' Committee (the Bondholders Committee), and Residual Based Finance Corporation (RESIDCO). The contents of these comments are summarized in Appendix A to this decision.

On September 17, 2003, petitioners filed a reply (designated CSX/NS-2) to the comments filed by NYCEDC, the Commonwealth, the Bondholders Committee, and RESIDCO. The contents of this reply are also summarized in Appendix A.

PRELIMINARY MATTER

NYCEDC requested that the procedural schedule be modified to give it extra time to file a rebuttal to petitioners' answers to certain questions NYCEDC raised in its August 28, 2003 filing. Petitioners provided answers to NYCEDC's questions in timely fashion. See Appendix A. NYCEDC has had these answers for several weeks, but has not filed any rebuttal. No good reason has been shown to justify adding delay to the procedural schedule in this case. NYCEDC's EDC-2 motion (filed August 28, 2003) for modification of the procedural schedule will be denied.

DISCUSSION AND CONCLUSIONS

The Supplemental Transaction. Under 49 U.S.C. 11327, the Board has continuing authority to enter supplemental orders and to modify decisions entered in merger and control proceedings under 49 U.S.C. 11323. See, e.g., Canadian National Railway — Control — Illinois Central Corp. [General Oversight], STB Finance Docket No. 33556 (Sub-No. 4), Decision No. 4 (STB served Dec. 26, 2001), slip op. at 4; Union Pacific Corp. — Control & Merger — Southern Pacific Rail Corp., STB Finance Docket No. 32760 (Sub-No. 21), Decision No. 1 (STB served May 7, 1997), slip op. at 3 n.3. The Supplemental Transaction proposed by petitioners consists of two parallel transactions, each of which in its own right would be subject to the jurisdiction of the Board under section 11323(a)(1) ("Consolidation or merger of the properties or franchises of at least 2 rail carriers into one corporation for the ownership, management, and operation of the previously separately owned properties."). Whether the Board's action here with regard to the proposed Supplemental Transaction is viewed as a "supplemental order" pursuant to section 11327 to permit alteration of certain aspects of the previously approved transaction, or as approval of two new consolidation or merger transactions pursuant to section 11323, the standard for approval is the same: the Board must find these transactions to be consistent with the public interest. And, as the Board noted in Decision No. 89, in determining the public interest, the benefits of a transaction must be balanced against any harm to competition or to essential service(s) that cannot be mitigated by conditions.

Because the record compiled in this proceeding demonstrates that the Supplemental Transaction "is consistent with the public interest," the Board will approve the Supplemental Transaction.

The Supplemental Transaction will conform the corporate structure of the three petitioners (CSX, NS, and Conrail) with the reality that has existed since the Split Date. The post-Split Date corporate structure, on the one hand, has shown NYC and PRR as wholly owned subsidiaries of Conrail. The post-Split Date corporate reality, on the other hand, has been that NYC and PRR have been integral parts of the CSX and NS rail systems, respectively. Once the Supplemental Transaction has been carried out, NYC and PRR will be consolidated within CSXT and NSR, respectively. The Supplemental Transaction will merely extend the existing rights of CSX and NS to control and operate NYC and PRR, respectively, to include full legal ownership of the properties and businesses of NYC

and PRR, respectively. The Supplemental Transaction, by effectuating a permanent legal division of the Allocated Assets between CSX and NS, will end certain undesirable features of the current corporate structure, and, by disentangling CSX and NS from unnecessary involvement in the operations and management of each other's Allocated Assets, will promote the procompetitive outcome of the Conrail Transaction. The Supplemental Transaction will allow CSX and NS to enjoy greater management control and independence over the assets of NYC and PRR, respectively, and will eliminate CSX's indirect involvement in major corporate actions affecting the PRR Allocated Assets and NS's equivalent role in major corporate actions affecting the NYC Allocated Assets. See Decision No. 1, slip op. at 6-8 (explaining these points in greater detail).

Petitioners have also demonstrated that the Supplemental Transaction will not adversely affect rail operations or rail service, whether involving the NYC and PRR Allocated Assets or otherwise, and thus will have no adverse impact on shippers.

Finally, even if this is viewed as an independent transaction requiring Board approval under section 11323, the five factors that would need to be considered under section 11324(b) are satisfied. (1) The Supplemental Transaction will not have an adverse impact on the adequacy of transportation to the public. (2) No other rail carriers have requested inclusion in the Supplemental Transaction. (3) The Supplemental Transaction will generate no new fixed charges. The Proposed Debt Restructuring, as its name suggests, involves only a "restructuring" of existing debt, not the creation of new debt. (4) Petitioners' employees will not be adversely impacted by the Supplemental Transaction, and, in any event, any such adverse impacts will be mitigated by the New York Dock conditions,⁵ which (as explained below) apply to the Supplemental Transaction. (5) The Supplemental Transaction will not have an adverse effect on competition among rail carriers in the affected region or in the national rail system.

Shared Assets Areas. The Supplemental Transaction will not affect the ownership structure of or rail operations within the three Shared Assets Areas, and therefore will have no effect on the competitive rail service provided by CSXT and NSR in those areas. And, even after oversight ends in 2004, the Board will have the power to prohibit any SAA change that conflicts with a condition imposed on the Conrail Transaction or that otherwise requires the approval of the Board under the governing statute.⁶

⁵ See New York Dock Ry. — Control — Brooklyn Eastern Dist., 360 I.C.C. 60, 84-90 (1979), aff'd sub nom. New York Dock Ry. v. United States, 609 F.2d 83 (2d Cir. 1979).

⁶ See CSX Corporation and CSX Transportation, Inc., Norfolk Southern Corporation and Norfolk Southern Railway Company — Control and Operating Leases/Agreements — Conrail Inc. and Consolidated Rail Corporation [General Oversight], STB Finance Docket No. 33388 (Sub-

(continued...)

Labor Protection. Petitioners contend that the Supplemental Transaction will have no adverse impact on their employees. None of their employees, petitioners explain, will be dismissed or displaced as a result of the Supplemental Transaction, and no changes will be required to be made to existing labor agreements or to the compensation, benefits, or working conditions of their employees. See Decision No. 1, slip op. at 8-9. The Board agrees that the Supplemental Transaction, which merely brings corporate structure in line with operational reality, should have no adverse impacts on petitioners' employees. Nevertheless, petitioners have suggested that labor protective conditions will be imposed. Therefore, the New York Dock conditions, which were imposed on the underlying transaction, will be imposed on the Supplemental Transaction as well.

Status Determination. Petitioners have requested that the Board find that CRC will continue to be a rail common carrier under 49 U.S.C. 10102(5) following the consummation of the Supplemental Transaction. No party has opposed this request. The Board agrees that, following the consummation of the Supplemental Transaction, CRC will remain a "rail carrier" as defined at 49 U.S.C. 10102(5). Cf. Decision No. 89, 3 S.T.B. at 374 ("We further find that, after the Closing Date, CRC will remain a 'rail carrier' as defined at 49 U.S.C. 10102(5).")⁷

The Proposed Debt Restructuring. Petitioners have asked that the Board's authorization of the Supplemental Transaction be made subject to a condition requiring petitioners to either: (i) resolve through negotiations any issues pertaining to the required consents of the Conrail debtholders;⁸ or (ii) propose further proceedings to determine whether the treatment of the Conrail debtholders under the terms of the Supplemental Transaction is fair, just, and reasonable. The Bondholders Committee contends, however, that, to allow consent negotiations between the Conrail debtholders and petitioners to proceed in a neutral environment, the Board should condition any supplemental order it may issue in

⁶(...continued)

No. 91), Decision No. 10 (STB served Nov. 5, 2002), slip op. at 7: "[The Port Authority of New York and New Jersey] is concerned that, absent oversight, CSX and NS, acting on their own initiative, may make fundamental changes in the nature of operations within the NJSAA. But even after oversight ends, we will have the power to prohibit any NJSAA change that conflicts with a condition imposed on the Conrail transaction or that otherwise requires our approval under the governing statute. And this is certainly true with respect to any fundamental changes to the SAAs."

⁷ The date referred to in this decision as the Split Date (June 1, 1999) has previously been referred to as the Closing Date and Day One. See Decision No. 89, 3 S.T.B. at 213 n.27.

⁸ Some of the agreements underlying Conrail's relevant debt obligations contain provisions requiring the consents of various parties (or of a majority of certain classes of debtholders) for certain corporate transactions, including the proposed transfer of NYC and PRR to CSX and NS, respectively. See Decision No. 1, slip op. at 10.

this proceeding on the successful completion of the consent solicitation process through registered exchange offers on Form S-4 under the Securities Act of 1933 in compliance with the terms of the agreements underlying Conrail's relevant debt obligations.

The Board has, under the applicable law, the authority to make a "fairness" determination (i.e., a determination that the treatment of the Conrail debtholders under the terms of the Supplemental Transaction's Proposed Debt Restructuring is fair, just, and reasonable) in the event the parties are unable to reach a negotiated agreement regarding the terms of the Proposed Debt Restructuring. See Schwabacher v. United States, 334 U.S. 192 (1948). The condition proposed by petitioners states (and does not in any way expand) the Board's authority to make such a fairness determination, and, therefore, the Board will impose the condition proposed by petitioners. The condition proposed by the Bondholders Committee, on the other hand, rejects sub silentio both the Board's authority to make a fairness determination and also the section 11321(a) exemption "from all other law" that underlies the Board's authority to make a fairness determination,⁹ and, therefore, the Board will not impose the condition proposed by the Bondholders Committee.

The Board wishes to emphasize that, although the Board is today authorizing petitioners to carry out the Supplemental Transaction described in the CSX/NS-1 petition, the Board is not today ruling that the treatment of the Conrail debtholders as contemplated in the Proposed Debt Restructuring is fair, just, and reasonable. Nor is the Board making a fairness determination, as no party has requested such a determination. If petitioners and the Conrail debtholders are unable to resolve through negotiations any issues pertaining to the required consents of the Conrail debtholders, any interested party (and not only petitioners) may propose further proceedings wherein the Board will make, if appropriate, a fairness determination.

FINDINGS

The Board finds that the Supplemental Transaction (i.e., the consolidation of NYC within CSXT and the consolidation of PRR within NSR, both as described in the CSX/NS-1 petition filed June 4, 2003), as conditioned herein, is consistent with the public interest.

⁹ Petitioners have advised that, if they propose further proceedings to determine whether the treatment of the Conrail debtholders is fair, just, and reasonable, they will also seek a ruling from the Board confirming that the section 11321(a) exemption "from all other law" permits consummation of the Supplemental Transaction without the consent of the holders of Conrail's outstanding debt obligations, and further confirming that immunity under section 11321(a) from contractual consent requirements related to Conrail's outstanding debt obligations is necessary to permit petitioners to carry out the Supplemental Transaction. See Decision No. 1, slip op. at 14.

The Board further finds that any rail employees of petitioners affected by the Supplemental Transaction will be protected by the conditions set out in New York Dock Ry. — Control — Brooklyn Eastern Dist., 360 I.C.C. 60, 84-90 (1979).

The Board further finds that, following the consummation of the Supplemental Transaction, CRC will remain a “rail carrier” as defined at 49 U.S.C. 10102(5).

The Board further finds that this action will not significantly affect either the quality of the human environment or the conservation of energy resources.

It is ordered:

1. The EDC-2 motion for modification of the procedural schedule is denied.
2. The Supplemental Transaction, as described in the CSX/NS-1 petition filed June 4, 2003, is approved.
3. Petitioners must either: (i) resolve through negotiations any issues pertaining to the required consents of the Conrail debtholders; or (ii) propose further proceedings to determine whether the treatment of the Conrail debtholders under the terms of the Supplemental Transaction is fair, just, and reasonable.
4. If petitioners carry out the Supplemental Transaction, they shall advise the Board in writing, within 10 days thereafter, that they have carried out the Supplemental Transaction.
5. No change or modification shall be made in the terms and conditions of the Supplemental Transaction, as set forth in the CSX/NS-1 petition filed June 4, 2003, without the prior approval of the Board.
6. Approval of the Supplemental Transaction is subject to the conditions for the protection of railroad employees set out in New York Dock Ry. — Control — Brooklyn Eastern Dist., 360 I.C.C. 60, 84-90 (1979).

7. This decision is effective on the service date.

By the Board, Chairman Nober.

Vernon A. Williams
Secretary

APPENDIX A: COMMENTS FILED

The New York City Economic Development Corporation. NYCEDC, acting on behalf of the City of New York, NY (the City), advises that, based solely on the information contained in the CSX/NS-1 petition, NYCEDC can neither support, oppose, nor remain neutral with respect to the Supplemental Transaction. NYCEDC explains that, although it applauds the efforts of the petitioners to enhance efficiency with the ultimate goal of improving their operations and the cost-effectiveness of the services provided to shippers in the City and the greater New York metropolitan area, the fact of the matter is that the petition, though long on generalities, is short on specifics as to how and why the projected results will be achieved. NYCEDC contends: that shippers in the City depend on the continuing viability not only of CSXT and NSR but also of Conrail; that, while petitioners imply that Conrail will continue to be in as sound a financial condition as it is now, they have not yet secured the consent of Conrail's creditors who might be affected by the Proposed Debt Restructuring; and that, in addition, petitioners have provided scant information on which NYCEDC can base a conclusion, leaving NYCEDC to rely solely on the representations in the petition that the Supplemental Transaction will not have any effect on either the ownership or operation of the Shared Assets Areas owned and operated by Conrail.

NYCEDC contends that, to permit NYCEDC and the City to decide whether to support, oppose, or remain neutral, petitioners must provide answers to seven questions. (1) At the time of the original Conrail Transaction, petitioners went to great lengths to create the current corporate structure and series of transactions between and among members of the CSX-NS-Conrail corporate families. What were the reasons for the existing structure? What has changed to make the proposed structure more desirable? (2) What will Conrail's balance sheet look like after the proposed restructuring? Other than the letters from Moody's Investors Services and Standard & Poor's that are attached to the CSX/NS-1 petition as Exhibits 5 and 6, respectively, has the financial community provided an opinion as to the financial viability of Conrail? (3) What are the respective long-term views of CSX/CSXT and NS/NSR with respect to Conrail and its future? (4) Are there additional financial and/or organizational changes planned for Conrail? (5) The documentation provided appears to indicate that Conrail will lose one of its most important missions (providing the allocated assets to CSX and NS) and its most significant revenue source ("rents" received from those assets). Is that correct? (6) What missions and cash flows will remain with Conrail? (7) Are they adequate to guarantee commercial stability?

Petitioners' Reply To NYCEDC. Petitioners, though they argue that NYCEDC's questions have largely been addressed in previous filings or seek information that is not relevant to the supplemental authorization sought in the CSX/NS-1 petition, have nevertheless attempted to provide answers to the questions raised by NYCEDC.

Re: NYCEDC's Question #1. Petitioners claim that the existing structure of Conrail, NYC, and PRR, and the reasons for that structure, were thoroughly explained in the Conrail Application. Petitioners further claim that the Conrail Application also advised that petitioners intended in the future

to restructure Conrail in the manner proposed in the CSX/NS-1 petition. Petitioners add that, based on their 4½ years of experience with the current shared ownership structure, they have determined that they can reduce costs and improve efficiency, reduce unnecessary entanglement between CSX and NS, and enhance the independence of CSX and NS by effecting a permanent division of ownership of the Allocated Assets between CSX and NS. The Supplemental Transaction, petitioners argue, will enhance the transparency and visibility of the overall financial results and performance of CSX and NS; will consolidate the ownership and management functions for the portions of the Allocated Assets now managed by CSX (i.e., NYC) and by NS (i.e., PRR), thereby eliminating a number of costs and inefficiencies resulting from the current joint ownership structure; will simplify the corporate structures of CSX, NS, and Conrail; and will provide CSX and NS greater independence to manage their respective shares of the Allocated Assets in accordance with the parent railroad's individual goals, needs, and opportunities.

Re: NYCEDC's Question #2. Petitioners advise that they expect that, upon completion of the Supplemental Transaction, Conrail's remaining assets will have a book value in excess of \$1.0 billion and will include 1,200 miles of track, three major classification yards, and 25 support yards serving the NJSAA, the SJ/PSAA, and the DSAA. Petitioners further advise that, if all of the holders of Conrail's unsecured debentures elect to participate in the Proposed Debt Restructuring, approximately \$800 million in unsecured debt will be removed from Conrail's balance sheet, and Conrail's remaining liabilities will comprise mostly deferred tax and pension liabilities, casualty reserves, and equipment and other lease-related obligations. Petitioners add that they expect that all of Conrail's equipment and lease-related obligations will be supported by leases or subleases between Conrail and either CSXT or NSR, and that they also expect that these supporting leases/subleases will have terms, conditions, and cash flows matching the controlling agreements between Conrail and the relevant debtors/equipment lessors. And, petitioners add, the 1997 "Keepwell Agreement" (detailed in section 4.3 of the Transaction Agreement, see Decision No. 1, slip op. at 13 n.15) will remain in full force and effect following the Supplemental Transaction.

Petitioners further advise that Moody's Investors Service and Standard & Poor's have reviewed the Proposed Debt Restructuring and have concluded (as more particularly described in Exhibits 5 and 6 to the CSX/NS-1 petition) that they would rate Conrail's secured debt A1/A respectively, a level (petitioners note) commensurate with Conrail's current secured debt ratings from those same credit agencies. Petitioners claim that these credit ratings companies are in a good position to assess Conrail's ability to pay its debts post-restructuring, and (petitioners maintain) their judgement should provide adequate comfort as to Conrail's on-going financial viability.

Re: NYCEDC's Questions #3, #5, #6, and #7. Petitioners advise that Conrail's mission after the Supplemental Transaction will be unchanged from its present mission, except that its role as landlord for the Allocated Assets will come to an end. Petitioners explain that, on the Split Date, Conrail's principal activity changed from that of a Class I line-haul carrier to operator of the Shared Assets Areas. Petitioners further explain that the services provided by Conrail in the SAAs allow CSXT and

NSR to provide competitive rail service in, to, and from the NJSAA, the SJ/PSAA, and the DSAA. Conrail's operations in the SAAs, petitioners maintain, will be unaffected by the Supplemental Transaction, and the balanced, competitive rail service now provided by CSXT and NSR in, to, and from the SAAs will be preserved. And, petitioners add: Conrail, as the owner/operator of the SAAs, will continue to receive fair-market value rent and operating fees for the services it provides to CSXT and NSR; Conrail will receive lease/sublease rental payments from CSXT and NSR in amounts sufficient for Conrail to pay its debt and lease rental obligations as they become due; and Conrail will continue to generate annual revenues from fiber optics, signboard licensing, and real estate and right-of-way sales and leasing. Petitioners also note that the 1997 Keepwell Agreement will remain in full force and effect, and will provide additional assurance that Conrail's cash flows will be adequate to maintain financial and operating stability.

Re: NYCEDC's Question #4. Petitioners advise that they have no current plans to make significant changes in the organization or operations of Conrail beyond those necessary to implement the Supplemental Transaction as described in the CSX/NS-1 petition. Petitioners add, however, that they will evaluate opportunities and conditions as they develop.

The Commonwealth of Massachusetts. The Commonwealth of Massachusetts advises that it supported the Conrail Transaction, based upon an agreement (the CSX/Commonwealth Agreement) dated October 31, 1997, that was executed by CSX and by the Commonwealth's Executive Office of Transportation and Construction. See Decision No. 89, 3 S.T.B. at 494 (the Commonwealth advised that "CSX has agreed to certain conditions which, if implemented, will bring about economic balance and enhance passenger/freight operational coordination"). The Commonwealth indicates that the CSX/Commonwealth Agreement contemplates meaningful cooperation and negotiation on a number of issues of high priority concern, which issues (the Commonwealth adds) include the Commonwealth's interest in extension of commuter rail service and resolution of ownership and operation of acquired lines deemed to be of critical importance to the Commonwealth.

The Commonwealth advises that it supports simplification of the ownership structure that resulted from the Conrail Transaction, with the expectation that such simplification will redound to the benefit of the Commonwealth and its constituents through increased efficiency and economy in rail service. The Commonwealth adds, however, that, whereas one of the objectives sought by petitioners is removal of impediments to dispositions of property, the Commonwealth is concerned that CSX may choose to proceed rapidly with disposition of rail assets currently within the NYC Allocated Assets. The Commonwealth advises: that CSX has committed to discuss the Commonwealth's interests in extensions of commuter rail services with flexibility of options as to funding, ownership, and operation of acquired lines; that these discussions have not yet been concluded; that the Commonwealth looks forward to continued cooperation with CSX regarding future disposition of properties in connection with passenger rail, freight rail, and rail banking initiatives; that the Commonwealth expects that the commitments referenced in the CSX/Commonwealth Agreement will be resolved to the mutual satisfaction of the parties under the continued oversight of the Board; and that the Commonwealth

anticipates that discussions between the parties will be completed and any outstanding matters of dispute resolved before CSX moves forward with new proposals for abandonment or sale of former Conrail lines within the Commonwealth. The Commonwealth adds that, to ensure the orderly disposition of rail properties in the Commonwealth to best serve the public interest, and recognizing the timeframes required to ensure adequate planning and funding, the Commonwealth is seeking to develop with CSX appropriate timeframes for prospective sales of Conrail/CSX properties to the Commonwealth and/or its agencies or authorities.

The Commonwealth therefore urges that the Board retain oversight over the underlying transaction through June 2004, as contemplated by Decision No. 89 and subsequent oversight decisions, to ensure full compliance with Decision No. 89 and related agreements between concerned parties.

CSX's Reply To The Commonwealth. CSX contends that, to date, it has complied with the commitments contained in the CSX/Commonwealth Agreement. CSX advises: that, in 2000 and 2001, CSX agreed to add six round-trip schedules to the commuter service operated by the Massachusetts Bay Transportation Authority (MBTA) between Framingham and Worcester on the Boston Main Line; that CSX has cooperated with MBTA regarding other proposed extensions of commuter service; that CSX is presently working with the Commonwealth to complete one of those proposed projects (extension of commuter service to Greenbush) and believes that this project is on target for completion within the timeframe contemplated by the parties; that CSX's representatives continue to meet on a quarterly basis with the Commonwealth's representatives to discuss a full range of immediate issues as well as long-term issues (including operational, engineering, passenger rail, real property, and economic development issues); and that CSX believes that these regularly scheduled meetings have provided, and will continue to provide, a constructive forum for communication. And, CSX adds, the Supplemental Transaction will facilitate CSX's ability to make plans with the Commonwealth to implement future projects in their common interest.

The Ad-Hoc Conrail Bondholders' Committee. The Bondholders Committee is an ad-hoc group that was formed to protect the interests of its members in their capacity as holders of a majority of the aggregate principal amount of the \$550,000,000 9.75% debentures due June 15, 2020, and the \$250,000,000 7.875% debentures due May 15, 2043 (together, the Debentures) issued by CRC pursuant to an Indenture dated as of May 1, 1990, as amended by a Supplemental Indenture dated as of August 25, 1998 (the Indenture). The members of the Bondholders Committee include Dodge & Cox and four other holders, some of whom hold the Debentures on behalf of their advised accounts.¹⁰

¹⁰ The comments of the Bondholders Committee were submitted by Dodge & Cox in its capacity as a member of the Bondholders Committee. The identities of the other members of the Bondholders Committee are not indicated in the comments.

The Bondholders Committee advises: that the Indenture provides for the issuance from time to time of unsecured debentures and other forms of indebtedness by CRC in one or more series; that the Indenture also includes various protective covenants pertaining to each series of securities outstanding under the Indenture; and that one such protective covenant (referred to as Section 8.2) requires that holders of not less than a majority in aggregate principal amount of the securities outstanding under the Indenture consent to the modification of certain rights belonging to the holders. The Bondholders Committee further advises that it believes that the Debentures are the only extant series of indebtedness outstanding under the Indenture, and, accordingly, are the only securities that will be subject to the consent solicitation.

The Bondholders Committee contends that, because the reorganization transaction proposed in the petition will entail retiring the existing Debentures and replacing them with new debt securities to be issued by two new obligors, majority consent of the existing bondholders (i.e., the consent of the holders of a majority of the aggregate principal amount of the Debentures) must be obtained. The Bondholders Committee further contends that its members have a strong interest in ensuring that the contractual arrangements upon which they based their decision to invest in the Debentures, including the supplemental indenture provisions, are honored by the petitioners.

To allow consent negotiations between holders of the Debentures and petitioners to proceed in a neutral environment, the Bondholders Committee asks that the Board condition any supplemental order it may issue in this proceeding on the successful completion of the consent solicitation process through registered exchange offers on Form S-4 under the Securities Act of 1933 in compliance with the terms of the Indenture. The Bondholders Committee advises that the Board's silence while negotiations proceed will maximize the opportunity to resolve any bondholder consent issues through the negotiation procedures prescribed by Article VIII of the Indenture and the registration requirements of Form S-4.

Petitioners' Reply To The Bondholders Committee. Petitioners advise that, once the Board has approved the Supplemental Transaction, they intend to commence negotiations with the relevant debtholders with the aim of obtaining the consent of those debtholders to the Proposed Debt Restructuring. Petitioners further advise that they would prefer to develop fair and reasonable terms for the necessary debt restructuring through negotiations, rather than invoke the authority of the Board to make a binding and overriding fairness determination. Petitioners maintain, however, that the law is clear regarding the Board's authority and responsibility to make a fairness determination in the event the parties are unable to reach a negotiated agreement regarding the terms of the necessary debt restructuring, see Schwabacher v. United States, 334 U.S. 192 (1948). Petitioners therefore advise that, if and to the extent the Bondholders Committee is requesting that the Board condition its approval of the Supplemental Transaction on the completion of the consent solicitation process through registered exchange offers, petitioners oppose this request. Petitioners further advise, however, that if the Bondholders Committee is requesting that the Board condition its approval of the Supplemental Transaction upon petitioners' resolution of issues concerning debtholders' consent through negotiations,

and that petitioners not ask the Board to commence a fairness proceeding unless consent negotiations with the debtholders fail to reach sufficient agreement(s), then petitioners and the Bondholders Committee have no material disagreement with respect to the CSX/NS-1 petition and the supplemental order it seeks.

Residual Based Finance Corporation. RESIDCO advises that, although the Supplemental Transaction will have an effect on Conrail's debt and equipment lease obligations requiring the consent of the holders of such obligations, RESIDCO is unable to grant its consent without the submission of answers to three questions: (1) Which entity will be making payments on the Agreement dated February 25, 2000, with Consolidated Rail Corporation Finance Number C100? (2) When will the financial statements of the entity making the payments on the Finance Number C100 Agreement be forthcoming? (3) Which entity will be acting as guarantor for the entity making the payments on the Finance Number C100 Agreement?

Petitioners' Reply To RESIDCO. Petitioners report that they have fully responded to the three questions posed by RESIDCO. Petitioners advise that, shortly after RESIDCO filed its comments, a Conrail representative contacted RESIDCO to discuss RESIDCO's questions regarding the effect of the proposed transactions on an equipment conditional sale agreement between RESIDCO and Conrail. Petitioners further advise that the Conrail representative explained to RESIDCO that, while Conrail would remain primarily liable for debt payments to RESIDCO, CSXT and NSR would also be directly liable under subleases to Conrail, whose terms would mirror those of the conditional sale agreement between RESIDCO and Conrail.